PERMODALAN PLANTATIONS SDN. BHD

v.

RACHUTA SDN. BHD.

FEDERAL COURT, KUALA LUMPUR
SALLEH ABAS LP
WAN SULEIMAN FJ
GEORGE SEAH FJ
[CIVIL APPEAL NO. 344 OF 1983]
6 OCTOBER 1984

CIVIL PROCEDURE: *The right to plead set-off and counterclaim - Effect.*

There were two related High Court suits. The first suit related to a breach of contract for the sale of mawa seeds and claimed damages for RM7.9 million and the suit was still pending. The second suit, which is the subject of the present appeal related to the appellants' demand for the refund of RM350,000 which they had given to the respondents to obtain a bank guarantee in connection with the contract for the sale of mawa seeds. The said contract (subject of the first suit) did not specifically provide for such a guarantee and it appeared that the appellants did not include it in the first suit but became an issue in the second suit.

The respondents justified withholding the said RM350,000 as a lien for 3 lots of monies they claimed the appellants owed them. The respondents therein pleaded this lien as a set-off and counterclaim.

At the High Court, the appellants had filed an O. 14 application for the refund of the RM350,000 and the respondents had pleaded the set-off and counterclaim. The Senior Assistant Registrar decided that the appellants were entitled to only part of their claim and withheld the balance pending the outcome of the trial. On appeal to the learned Judge, he confirmed the Senior Assistant Registrar's decision and held that the respondents were entitled to plead set-off because it was closely related to the appellants' claim. The appellants appealed.

Held:

[1] The Senior Assistant Registrar has the discretionary power by entering judgment for only part of a claimed sum.

[2] In Malaysian Law, there was no legal right of set-off but only equitable set-off. Definition of a set-off is a cross-claim for a sum of money by a defendant against a plaintiff's claim for another sum of money for which the defendant is being sued. Whether or not a plea is a set-off has to be determined as a matter of law and substance. The matter sought to be set off must essentially be connected with or form part of the matter upon which the plaintiff's action is founded.

[3] Definition of counterclaim is also a cross-claim which a defendant has against a plaintiff but in respect of which the defendant can bring a separate action against the plaintiff if he wishes to do so.

[4] On the facts of this case, the respondents were entitled to plead set-off in the second suit because the lien on the monies claimed by the respondents under the contract of sale of mawa seeds is closely related to the appellants' claim for the refund under the guarantee.

Although the contract of sale did not provide for the guarantee, the said contract could not be performed without the guarantee and as such the two became inextricably related. Accordingly, it was proper for the respondents to raise the plea of set-off.

[Appeal dismissed]

Cases referred to:
Hanak v. Green [1958] 2 QB 9
In re A Bankruptcy Notice [1934] Ch 431
Rawson v. Samuel [1841] Cr & Ph 161
Damodaran v. Vasudevan [1975] 2 MLJ 231; [1979] 2 MLJ 267
Pahang South Union Omnibus Co. Bhd. v. Ministry of Labour and Manpower [19841] 2 MLJ 199; [1981] CLJ (Rep) 74
Federal Commerce & Navigation Co. Ltd. v. Molena Alpha Inc. [1978] 3 WLR 309

Legislation referred to:
Rules of the High Court 1980, O. 14 r. 3, O. 15 rr. 2, 3, 4, 5, O. 18 r. 17, O. 27 r. 3
Civil Law Act 1956, s. 3(1), s. 6
Courts of Judicature Act 1964, s. 25(2)
National Land Code 1965, s. 417
Supreme Court of Judicature Act 1873 (UK), s. 24(3)

Other source referred to:
Halsbury's Laws of England 4th Edn., Vol. 42, para. 402.

For the appellants - C. Abraham; M/s. Shearn Delamore & Co.
For the respondents - V.K. Palasuntharam; M/s. Choong Yik Son & Co.

JUDGMENT

Salleh Abas LP:

This is an appeal from the decision of Dr. Zakaria J confirming the decision of a Senior Assistant Registrar on the appellants' application for a final judgment under O. 27 r. 3, the ground being that the respondents had made admissions to the appellants' statement of claim.

The facts are as follows:

The appellants entered into an agreement on 30 January 1981 with the respondents to buy mawa coconut seeds from the latter at RM6.50 per seed. Under this agreement (hereinafter referred to as "the sale agreement") the respondents undertook to ship the seeds to any destination specified by the appellants and are entitled to be reimbursed for the costs and expenses in connection with the shipment. Subsequently, disputes arose between the parties and as a result the appellants commenced two civil suits against the respondents.

In the first suit No. C. 1063/82 the appellants alleged that the respondents had committed a breach of the sale agreement by supplying them with non-mawa seeds and they therefore claimed by way of damages a sum of RM7,982,251.50 under Clause 9 of the sale agreement which fixed such damages to be at the rate of RM10 for each seed. The respondents denied liability and contended that Clause 9 was a penalty and not a compensation. Attempts by the appellants to proceed to a summary judgment failed because the Court allowed the respondents an unconditional leave to defend. This suit (C. 1063/82) is thus still pending.

In the second suit C. 1270/82, which is the subject matter of the present appeal, the appellants asked for a refund of a total sum of RM350,000 which they on various occasions had given to the respondents in order to provide a bank guarantee required by the Royal Malaysian

Customs in connection with the shipment of mawa seeds to the appellants. Under the sale agreement no provision was made requiring the appellants to make this amount to the respondents. Thus, the parties agreed as per the appellants' letters dated 9 February 25 March 5 May and 15 May 1981 (Exhibits TMH1, TMH2, THM3 and TMH4, attached to the affidavit of Tan Mee Hoi (f) sworn on 15 June 1983) that the money was paid as a deposit to meet the requirement of the Royal Malaysian Customs "in the performance of" the sale agreement and that it should be refunded "in full upon the cessation of the sale agreement or earlier if the parties mutually agree". For ease of reference these letters will be referred to in this judgment as "the guarantee agreement".

The respondents admitted receiving the sum but denied liability to refund the full amount. They justified withholding the sum by claiming a lien on it because the appellants did not pay them three sums of money which they alleged to have been due to them. Therefore, they pleaded a defence of set-off and added a counterclaim thereto. The three sums which they alleged were due to them are-

(1) RM223,756 being the balance of the price of mawa seeds supplied to the appellants which they had not paid;

(2) RM40,000 being the price of 2,000 bags of rock phosphate supplied to the appellants; and

(3) RM6,543.30 being the handling and other charges incurred by the respondents in shipping the seeds to the appellants.

In reply to the respondents' defence, the appellants contended that no such defence of set-off could be allowed in this suit (C. 1270/82) because the respondents had already admitted receiving the sum of RM350,000 as claimed and that if they wish to set up a defence of set-off, they should do so in the first suit (C. 1063/82) because the sums sought to be set-off by the respondents all relate to the performance of the sale agreement in respect of which the first suit was instituted.

The respondents' reply to this contention is that suit C. 1063/82 is not the proper place in which they could raise their plea of set-off and counterclaim, because in that suit they had completely denied liability.

The appellants' application for a final judgment under O. 27 r. 3 was heard by a Senior Assistant Registrar, who then decided that the appellants were not entitled to the full sum but only to a sum of RM79,700.70 and that the balance of their claim, i.e., RM270,299.30 was to be withheld until the respondents' set-off and counterclaim would be tried.

The ensuing appeal was heard by Dr. Zakaria J The learned Judge confirmed the decision of the Senior Assistant Registrar. He held that the respondents are entitled to plead a defence of set-off under O. 18 r. 17 because the respondents' counterclaim and set-off were closely related to the appellants' claim.

In the further appeal before us, Mr. Cecil Abraham for the appellants put up a very pedantic and technical submission tracing the history of set-off in England and comparing it with the position in this country. He prefaced his submission by raising a question whether there is a separate concept of legal set-off in our law? He answered this question saying that in our law there is no distinction between a counterclaim which is provided for in O. 15 rr. 2 and 3 of the Rules of the High Court and a defence of set-off mentioned in O. 18 r. 17 and that

unless the defence of set-off is so closely connected with the appellants' claim as to impeach their titles to be paid, the plea should not be accepted. In this case, he submitted, the amounts required to be set-off are not connected with the appellants' claim and as such they are only a counterclaim within the meaning of O. 15 rr. 2, 3, 4 and 5 and so the appeal should be allowed.

Mr. Palasuntharam for the respondents on the other hand argued that there is a distinction between a defence of set-off and a counterclaim and that in this appeal he relied on both legal as well as equitable set-off.

Looking at the issue raised by the pleadings in this case, and the judgment given by the Senior Assistant Registrar which has become the subject of the appeal before the High Court and this Court we notice that all that the learned Senior Assistant Registrar decided was that until the respondents' defence of set-off and counterclaim are finally decided in a trial the appellants in the meantime are entitled to a judgment of RM79,700.70 only. Surely, this judgment has not the effect of finality as regards the respondents' set-off and counterclaim as these remain to be tried. If in a future trial the Court decides against them the appellants will get the balance of the sum and if the Court's decision will be in their favour the respondents will be entitled to withhold the balance and not bound to refund it to the appellants. The decision of the Senior Assistant Registrar is therefore concerned with the question of convenience and maintenance of *status quo* between the parties. We cannot see anything wrong with this decision because O. 27 r. 3 itself under which the appellants applied for the final judgment empowers the Court to "give such judgment, or make such order, on the application as it thinks just."

Surely, this power is not obligatory in the sense that the Court is bound to give the judgment in terms of the application whenever there is an admission by a defendant to a plaintiff's statement of claim despite the existence of circumstances which in its view require a modification. Power is always discretionary and we see nothing wrong in the exercise of this power by the Court in not entering a judgment for the full sum.

Further, even if we accept the submission of Mr. Cecil Abraham that the respondents' defence of set-off is nothing but a counterclaim it is still open to the Court to make the decision which the learned Senior Assistant Registrar did, because the judgment given is really a summary judgment in respect of which O. 14 r. 3 says:

> ...The Court may give such judgment for the plaintiff against that defendant on that claim or part as may be just having regard to the nature of the remedy or relief claimed.
>
> (2) The Court may by order, and subject to such condition, if any, as may be just, stay execution of any judgment given against a defendant under this rule until after the trial of any counterclaim made or raised by the defendant in the action.
>
> (See also Halsbury's **Laws of England** 4th Edn., Vol. 42, para 402).

Now let us turn our attention to the question whether or nor in our law there is a distinction between a set-off and a counterclaim. For this purpose it is convenient to set below O. 18 r. 17 and O. 15 r. 2:

> **Order 18, r. 17 (Defence of set-off)**
>
> 17. Where a claim by a defendant to a sum of money (whether of an ascertained amount or not) is relied on as a defence to the whole or part of a claim made by the plaintiff, it may be included in the defence and set-off against the plaintiff's claim, whether or not it is also added as a counter-claim.

Order 15, r. 2 (Counterclaim against plaintiff):

2. (1) Subject to r. 5(2), a defendant in any action who alleges that he has any claim or is entitled to any relief or remedy against a plaintiff in the action in respect of any matter (whenever and however arising) may, instead of bringing a separate action, make a counterclaim in respect of that matter; and where he does so he must add the counterclaim to his defence.

(2) Rule 1 shall apply in relation to a counterclaim as if the counterclaim were a separate action and as if the person making the counterclaim were the plaintiff and the person against whom it is made a defendant.

What is set-off?

A set-off is a cross-claim for a sum of money by a defendant against a plaintiff's claim for another sum of money for which the defendant is being sued. A cross-claim is not necessarily a set-off, merely because the word used in the pleading is "set-off". Whether or not the plea is a set-off it has to be determined as a matter of law and substance: *Hanak v. Green* [1958] 2 QB 9. A cross-claim which is accepted as a defence of set off has the effect of extinguishing either the whole or part of the plaintiff's claim. See *In re A Bankruptcy Notice* [1934] Ch 431. But to constitute a set-off the sum of money meant as a cross-claim must from its nature and quality be such that it is proper to be dealt with as a defence to the plaintiff's claim and not as a separate cause or matter.

At common law a right of set-off was not recognized despite the fact that a defendant had a valid claim against a plaintiff. Thus, in order to prevent imprisonment of such a defendant, two statutes, known as Statutes of Set-off, were passed in 1728 and 1734. Although these statutes and the subsequent statutes were repealed, the principle has been preserved by successive statutes even to this day. In addition to the statutory set-off, the Court of equity has all along been in the habit of allowing a defendant to restrain a plaintiff from proceeding at law where in view of the defendant's cross-claim, the Court thinks that it is unjust for the plaintiff to proceed with his suit at law. This is known as "equitable set-off" and it operates as Lord Cottenham LC said where there is an equity which goes to impeach the title of the legal demand. *Rawson v. Samuel* [1841] Cr & Ph 161. The fusion of law and equity in 1873 does not affect this principle either.

As regards our law, s. 25(2) of our Courts of Judicature Act gives a number of additional powers to the High Court, one of which is to allow a defence of set-off (see item 13 of Schedule). However, the proviso to the section requires this power to be exercised "in accordance with any written law or rules of Court relating to the same.

We know that in English law there are two types of set-offs, statutory set-off and equitable set-off. The question is whether both these set-offs are applicable as part of our law? The answer to this question depends upon the effect of s. 25 (2) together with its proviso and the Schedule. In *Damodaran v. Vasudevan* [1975] 2 MLJ 231 Suffian LP whose opinion was agreed to by two other members of this Court, i.e. Lee Hun Hoe CJ (Borneo) and Wan Suleiman FJ held that the Court has power to make an order on any matter specified in the Schedule, irrespective of whether there is or there is no written law or rules of Court relating to that matter. In his view the proviso means no more than that if there are written law or rules of Court relating to the same, the Court's power must be exercised in accordance with them and that if there are no such law or rules, the proviso does not mean that power cannot be exercised at all. In the latter circumstances it was held that the Court could exercise the power and is entitled to fall back on the English law on the matter. Thus the Federal Court ruled that a claimant in a land dispute pending before the Court (the caveat lodged by him

having been removed) was entitled to register *lis pendens* against the disputed land and to maintain the registration until the determination of the dispute, notwithstanding that there is no written law or rules of Court relating to the registration of *lis pendens.* Although the case *Damodaram v. Vesudevan* went up all the way to the Privy Council, the Court's interpretation of s. 25(2) and the Schedule as the statutory source of power to order the registration of *lis pendens* was not taken up as an issue in the appeal. However, looking at the veiled comments and observations of Lord Diplock who delivered the judgment of the Privy Council [1979] 2 MLJ 267 @ 270 no one would fail to notice that the value of the Federal Court's decision of s. 25(2) is considerably reduced. His Lordship without touching this section at all (because there was no appeal) emphatically said that "neither the original common law doctrine of *lis pendens* nor the statutory modifications of it in England have any application to Malaysia". His Lordships based this view on s. 6 of the Civil Law Act 1956 which expressly excludes the law of England relating to land from the general reception of English Common Law and rules of equity as part of the law of Malaysia and also on the absence of any provision in the National Land Code for the registration of *lis pendens.* Attempt to argue that s. 417 of the Land Code was sufficient to provide for the registration was rejected by His Lordship, saying that this section-

> ... does not authorise the Court to direct the Registrar to make on the register entries of a kind for which no express provision is made by the National Land Code and which are inconsistent with the whole scheme of the Act, nor was s. 417 relied on by the Federal Court...as the source of power to order for registration of an order of *lis pendens.*
> (p. 270).

It is clear from the observation of Lord Diplock that unless there is a written law or rules of Court on the specified matter in the Schedule, the power conferred by s. 25(2) on that matter remains unexercisable. This is the view taken by the later decision of this Court in *Pahang South Union Omnibus Co. Bhd. V. Ministry of Labour and Manpower* [1981] CLJ (Rep) 74, wherein Abdoolcader J (as he then was) delivering the judgment of the Court said that s. 25(2) only confers enabling powers in respect of the matters specified in the schedule.

Now what are our written laws or rules of Court which deal with a defence of set-off so as to enable the Court to make an order relating thereto?

We have no statutes dealing with a defence of set-off as are available in the United Kingdom. Neither have the United Kingdom statutes on the subject been incorporated in our Civil Law Act 1956 which deals with the reception of English law in this country. Section 3(1) of this Act only enacts that "the Court shall, in West Malaysia or any part thereof, apply the Common Law of England and the rules of equity as administered in England on the 7 April 1956". Clearly, equitable set-off is included in the expression "rules of equity" which the Court is required to apply under the section. But the legal set-off which is based on statute is in no way included in the expression "the Common Law of England" which we are required to apply. Thus, there being no Malaysian Statutes comparable to the United Kingdom Statutes on the subject, we therefore hold that only equitable and not legal set-off is part of our law, and consequently the Court can only deal with an equitable set-off.

The characteristics of set-off as contained in O. 18 r. 17 are that (1) it is a cross-claim for a sum of money, ascertained or otherwise; (2) it is relied as a defence to meet the whole or part of plaintiff's claim, and (3) that it is immaterial whether it is added or not as a counterclaim as long as it is included in the defence. Thus, if a cross-claim relied on by the defendant as a set-off does not and cannot absolve the plaintiff's claim because it arises from a separate

transaction, we agree that the cross-claim is not necessarily a set-off, though it is so described, and that such cross-claim could, because of its nature and quality, only amount to a counterclaim. (See Lord Denning MR in *Federal Commerce & Navigation Co. Ltd. v. Molena Alpha Inc.* [1978] 2 WLR 309 @ 337-338).

What then is a counterclaim?

A counterclaim on the other hand is also a cross-claim which a defendant has against a plaintiff but in respect of which the defendant can bring a separate action against the plaintiff if he wishes to do so. Thus, to all intents and purposes a counterclaim is a separate and independent action by the defendant, which the law allows to be joined to the plaintiff's action in order to avoid multiplicity or circuity of suits. Like set-off, a counterclaim is also the creation of Statutes. At common law the Court has no power to allow an action by a plaintiff to be met by a cross-claim of the defendant against the plaintiff. The Court simply left the defendant to commence a separate action. It was only by virtue of the Supreme Court of Judicature Act 1873, s. 24(3) that enabled the defendant's counterclaim to be added to the plaintiff's suit.

In so far as our law is concerned, a counterclaim is governed by the provisions of O. 15 r. 2 which we have already set out earlier.

It is, therefore, clear that a counterclaim is wider than a defence of set-off and that whilst the former is a separate action by a defendant against a plaintiff the latter is essentially a defence, although a defendant is entitled to add it as a counterclaim. Being a defence to a plaintiff's action, the matter sought to be set-off must essentially be connected with or form part of the matter upon which the plaintiff's action is founded. Indeed Mr. Cecil Abraham conceded this point.

With this principle in mind in that a set-off is a defence and that if a counterclaim consisting of matters to be set-off is added to the defence, such counterclaim becomes a special kind of counterclaim, and that the set-off must be clearly connected with the claim, let us now examine the three items, which the respondents plead as set-off:

(1) As regards the sum of RM40,000 there is no dispute that it is the price for the supply of 2,000 bags of phosphate to the appellants who have yet to pay the sum. Although it is neither within the sale agreement, nor within the guarantee agreement, nevertheless, as alleged, it is a mutual debt due from the appellants. This is a sort of situation contemplated in the judgment of Morris LJ in *Hanak v. Green (supra)* in which his Lordship said could be set-off because the appellants should give credit for it.

(2) As regards the sum of RM6,545.30, there is also no dispute that this sum was incurred by the respondents in connection with the shipment of mawa seeds and for which the appellant agreed, under the sale agreement, to reimburse; and

(3) As regards the sum of RM223,756, this is the respondents' claim in respect of the balance of the price of mawa seeds supplied to the appellants, which, according to the respondents' allegation, is still owing and remains to be paid. Clearly this claim is based on the sale agreement.

Unless the sale agreement under which the two sums in (2) and (3) above are claimed and the guarantee agreement under which the appellants' suit for RM350,000 is based are treated as being clearly connected with each other or as one cause or matter, these sums cannot constitute a defence of set-off, but only as a counterclaim.

In our judgment, these two agreements must be treated as inter-connected and constituting one cause or matter; the guarantee agreement being complementary to the sale agreement. The object of the sale agreement is for the purchase and supply of mawa coconut seeds by the respondents to the appellants. Under its Clause 5 the respondents are required to ship the seeds to a destination specified by the appellants and under Clause 6 they are entitled to be reimbursed for the expenses incurred in connection with the shipment. To enable the shipment to be done, the respondents needed money to provide a bank guarantee required by the Royal Malaysian Customs. But the sale agreement made no provision regarding the money and bank guarantee. It is obvious that unless the guarantee were furnished the sale agreement could not be performed because the Customs would not allow the shipment. In such a case the result would be that the respondents would not be able to ship the mawa seeds and the appellants would not be able to receive them. In our view, this is a sort of omission which, if the parties had thought of when they entered into the sale agreement, they would have included it in the sale agreement. In fact this is clearly recognised by the appellants themselves when they said in their letters relating to the payment of the sum of RM350,000 that the money was paid as a deposit and that it was paid "to meet the requirement of the Royal Malaysian Customs in the **performance** of the mawa seednuts Supply Agreement dated 30 January 1981." Thus the advances by the appellants and the receipt by the respondents of this sum, in our judgment, are part of the Sale agreement. The signing of the Guarantee agreement which refers to this sum does not render it to be a separate agreement nor an independent transaction; it being supplemental to the former.

For the reasons given above we dismiss the appeal with costs. The deposit must be paid to the respondents on account of taxed costs.

Also found at [1985] 1 CLJ 62